

**Department of Commerce
Federal Trade Commission**

**Public Workshop: Alternative Dispute Resolution
For Consumer Transactions in the Borderless Online Marketplace**

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Introduction

The Internet has created new consumer transaction paradigms by reducing transaction costs and increasing accessible consumer information. For example, the numerous auction sites that match buyers and sellers from disparate geographic locations would have been unthinkable without a vast network through which multiple parties share information and communicate in various ways to reach agreement. Although the Internet allows buyers and sellers to exchange more information than would be possible in the traditional transaction context, transaction-based disputes continue to arise. In fact, due to other conditions inherent to online transactions, certain disputes may arise more frequently.

The increasing number of Internet-based disputes offers an opportunity for creative problem solving to craft appropriate resolution systems. The importance of such systems has not escaped the Office of Economic and Consumer Development, which has a goal to, “encourage business, consumer representatives and governments to work together to continue to provide consumers with the option of alternative dispute resolution mechanisms that provide effective resolution of the dispute in a fair and timely manner and without undue cost or burden to the consumer.”

WebMediate is based on the belief that the problem created by one of the greatest technological innovations of our time will be best addressed by fusing it with one of our time’s greatest interpersonal process innovations—broadly, alternative dispute resolution. WebMediate will pursue this fusion of technology and interpersonal process with the launch of www.webmediate.com during the summer of 2000.

Existing Alternative Dispute Resolution Programs

1) What types of ADR are there? Are certain types better suited for online transactions?

The processes known as alternative dispute resolution range from simple negotiation to binding arbitration with almost every imaginable gradation and combination

¹ WebMediate, Inc., is a Massachusetts-based online dispute resolution company formed by top-tier scholars, practitioners, technologists and entrepreneurs to provide a high-quality dispute resolution service. WebMediate will launch in the summer of 2000 at www.webmediate.com. For more information, e-mail info@webmediate.com.

in between. Some of the more common variations of alternative dispute resolution are as follows:

1. Arbitration—a process that can be binding or non-binding, in which the parties present their arguments to a neutral. The neutral then issues a finding. Arbitration cases involve choice of law issues and are usually governed by a specified set of procedural rules, such as those promulgated by AAA, ICC, LCIA or UNCITRAL.
2. Mediation—a process in which a neutral works to facilitate a dialogue between the disputants to reach an agreement. The neutral can offer evaluation of certain elements of the case, or the neutral can simply facilitate the resolution dialogue.
3. Negotiation—the process of direct communication between two parties to a dispute with the goal of achieving resolution.

Within and between each of these general categories is a number of variations. The critical variable across the ADR spectrum is the amount of control the parties have over process and substantive outcome. Negotiation gives the most power to the parties, allowing them to work within their own structure. On the other end of the spectrum, arbitration, because its rules are fixed and it is run by a third-party, allocates most of the power to the neutral(s).

The question of which ADR systems are best suited to handle online commercial disputes depends on both the nature of the particular type of dispute and on the nature of the parties' relationship. Thus, it is hard to generalize about the suitability of certain ADR practices to the Internet. Any attempt to generalize about such practices must be qualified with the statement that if disputes differ, each dispute resolution process may need to differ.

In deciding whether certain types of ADR are suitable for online transactions, the primary consideration should be to create a structure that ensures the parties' ability to meet their interests in a fair and efficient manner. Structures allocating more control to the parties will allow for efficiency adjustments and increase the likelihood that any agreement reached is based on relevant interests. Furthermore, structures through which the parties reach their own resolution reduce the need for complicated enforcement mechanisms. Structures involving a neutral will usually be better at ensuring fairness of process as the neutral serves to monitor the process, maintaining a virtual atmosphere of impartiality.

Within neutral-governed ADR processes, arbitration will be efficient in that the neutral can dictate process based on applicable governing principles. However, arbitration raises the problems of process management and enforcement as well as legal concerns, such as choice of laws issues. Because arbitration is normally governed by a set of

enumerated rules, the parties will have less flexibility than they would under different ADR regimes. Enforcement of arbitrated decisions may require that the parties stipulate to the terms and submit the agreement to the court for ratification. In the non-binding arbitration setting, Because the neutral in an arbitration will have to make a decision based on fact and law, the parties will have to agree to a certain body of law. Since parties transacting on the Internet are frequently geographically disparate, the choice of law problem may be significant.

Mediation gives the parties more control, allowing them to dispense with certain procedural elements that may be required under certain arbitration regimes. The ability to control and structure process meets the interest of parties in the commercial transaction context in minimizing expenses. Mediation is also well suited to resolve commercial Internet disputes because it demands a high level of party participation and facilitates positive interaction between the parties. The participation of the parties in formulating the resolution increases the likelihood that the parties will base agreement on their core interests and that they will adhere to the final agreement. This interaction can create better relationships going forward while resolving the dispute.

Finally, a combination of processes, such as med-arb or arb-med may offer the best of both arbitration and mediation, depending on the needs and goals of the parties. These processes may allow the parties to take desired elements from more than one dispute resolution regime. However, under hybrid regimes such as med-arb or arb-med, process decisions become complex and may stall the resolution.

To meet the needs of collective disputants, an ADR regime must provide more than one process step. Usually, negotiation is the first type of alternative dispute resolution attempted by the parties. Parties entering mediation or arbitration processes have often failed at negotiating a settlement. Because of its flexibility and focus on the parties' interests, mediation is most often the first step in a formal alternative dispute resolution system. Because mediation relies on voluntary party participation, it is most effective when parties are not mandated to participate. Arbitration is also frequently a first step, but this is usually the case only when parties have either contracted ex ante to arbitrate all disputes or when an arbitration norm is in place within the industry. Arbitration is often a backup effort to resolve disputes that parties fail to resolve in mediation.

2) Under what circumstances is ADR used to resolve disputes about consumer transactions today? How does ADR work in such cases? How are decisionmakers or mediators selected under an ADR program? What lessons can be taken from such a mechanism?

ADR is increasingly popular in virtually every field. Currently, ADR in commercial disputes is applied in a more limited sense than in other settings, such as probate and housing court settings. Thus, the growth potential for ADR in commercial dispute resolution is great.

The delay of the commercial world to more fully adopt ADR can be explained by several factors. The most significant factor holding back a more widespread adoption of ADR in commercial disputes is awareness of ADR processes and of ADR's benefits. Corporate culture is another barrier. Most business firms have strong adversarial cultures fostered by large legal departments. These legal departments are usually beholden to the litigation norm and they increase the commercial disputant's willingness to pay. In addition, certain complex commercial disputes involve high dollar figures and involve more sophisticated parties that are willing to pay more to resolve their dispute, or, as is often the case, such parties are willing to pay more to not resolve the case (i.e., let the case sit on the court docket for years). That said, it is still important to recognize that the presence of ADR in commercial dispute resolution is steadily increasing. In the commercial dispute setting, ADR is generally pursued in two circumstances—either the governing contract contains an ADR clause or the parties decide to pursue ADR instead of going forward with adjudication. The eventual type of ADR and the course of the ADR process depends on the nature of the transaction or the specifics of the relevant contract.

Several courts have ADR programs that push disputes into mediation programs structured to resolve disputes in a way that better meets the needs of disputants. In the Alternative Dispute Resolution Act of 1998, Congress required that ADR be an integral part of judicial administration in the federal courts.² Before this statute, the 1990 Civil Justice Reform Act required a few jurisdictions to do ADR experiments and incentivized all others.³ The current mandate states that every federal court must provide an ADR alternative for almost every case. In some courts, the ADR program is mandatory. Most states have analogous laws, requiring state courts to provide and even incentivize ADR alternatives for docketed cases.

The results of ADR's proliferation have been largely positive. A Federal Judicial Committee study in the 1980s asked parties with filed claims to choose the vehicle they felt would provide them with the best forum on the basis of fairness, cost and delay. The results of the study were 12 percent felt the jury trial would be the fairest, 43 percent preferred a bench trial, 16 percent preferred arbitration and 29 percent were undecided. Recently, the same questions were asked of parties with filed claims. The results show the increasing popularity of ADR. Of the parties asked in the recent study, 12 percent referred the jury trial, about 20 percent preferred the bench trial, 50 percent preferred arbitration and 20 percent were undecided.

ADR's success is due to the advantages of lower cost, reduced time and better relation-building elements that it offers to both parties. ADR's benefits apply particularly to commercial firms because of the decreased transaction costs, the opportunity for parties

² See, Alternative Dispute Resolution Act of 1998, Pub. L. No. 105-315, 112 Stat. 2993, 2994 (1998).

³ See, Civil Justice Reform Act of 1990, Pub. L. No. 101-650, 104 Stat. 5089 (1990) (codified at 28 U.S.C. S 471-483 (1996)).

to improve relationships and the parties' ability to create settlements that meet the parties' interests.

The selection of neutrals is one of the most important process elements in a system of alternative dispute resolution. In most off-line commercial disputes, parties opting for ADR must agree on the process. Selection of neutrals is one of the first process points that the parties may encounter. In commercial arbitration, the parties have several choices among rules. Once the parties have agreed upon a certain arbitration regime, they can select the appropriate neutrals based on the relevant rules and move forward with the process. In mediation, the parties often must agree on a certain neutral. Several organizations such as CPR and AAA offer assistance in the neutral selection process.

3) What ADR programs currently exist for online consumer transactions? Do these programs address cross-border transactions? Please describe these programs and how they work. In describing the programs, please address issues such as fairness, effectiveness, affordability, accessibility, and due process concerns.

Several online ADR programs currently exist. The current online dispute resolution offerings can be divided into two general categories. The first category is automated process, and the second category is a neutral-managed process.

The automated process is generally managed by a computer which runs parties' bids through an algorithm to determine if there is a zone of possible agreement between the parties and if there is such a zone, what the optimal solution is. Automated online ADR processes have been in use for a few years. They are inexpensive and easy to access. Because there is only information sharing in the case that the parties actually reach agreement, parties need not fear that the process will weaken their position in potential future dispute resolution processes through spillage.

Automated processes are fair to the extent that both parties can represent their optimal outcome in numerical terms. One of the greatest problems with automated systems is the difficulty of representing certain parties' interests. Since the algorithm only analyzes numerical values, the parties are forced to put a number score to all of their interests. The requirement to assign number values to diverse interests rules out certain disputes from participating in automated processes. In addition, the automated processes do not allow for communication between the parties so there is no relationship building. Parties submit to this process either by initially filing a claim or by responding to a filed claim. Once one of the parties to a dispute files a claim, there is a mechanism that solicits the participation of other concerned parties.

Automated dispute resolution is primarily used in the resolution of insurance claims, although such systems could resolve any dispute that parties can value in numerical terms. Although settlement rates from such automated programs are still down around 40

percent, there is reason to hope that this number will increase as automated systems become the norm in certain fields.⁴

For any disputes involving parties whose interests can be easily represented by numerical values, automated dispute resolution makes sense, at least as a first-step, since the cost of participation and the risks of information spillage are nominal.

Neutral-managed online dispute resolution sites offer disputants an ADR system with the advantages of the Internet along with the strengths of trained neutral management. Neutrals in web-based systems conduct the proceedings in a substantially similar manner to the off-line world. Because ADR is a dynamic process, the neutrals and the parties on the Internet are able to shape the process to leverage certain elements of technology as the process unfolds.

Because neutrals are able to monitor the process and because the Internet places a technological wall between the parties, online ADR promises high levels of fairness. For example, the physical separation prevents parties from using certain coercive tactics. Online dispute resolution also promises to increase the fairness of the ADR process by reducing the costs associated with ADR, so that more parties can afford to enter the dispute resolution system. Specifically, because the Internet reduces overhead costs and allows parties to do more in less time, the dispute resolution process costs will not prevent certain parties from entering ADR. Since the Internet is fast becoming ubiquitous, accessibility is one of online ADR's greatest strengths. Parties can log on to secure accounts and conduct online dispute resolution processes from any Internet connection.

Currently, neutrals and parties in the web-based system communicate through email, message boards and chat rooms. As new technologies emerge to facilitate real-time audio and visual communication over the Internet, the functionalities of online dispute resolution will increase.

Several variables differentiate the current and anticipated offerings of neutral-managed online dispute resolution. Among these variables are available ADR processes, qualifications of neutrals, fee structures and the amount of disclosure required.

Both automated and neutral-managed online dispute resolution systems are well suited to handle cross-border disputes, although systems in which the parties surrender decision-making power to the neutral, such as arbitration proceedings, require that the parties agree as to which body of law applies. In the case of disputes involving parties from different states, the parties would likely be required to stipulate to a certain forum's laws. The choice of laws problem may present problems in the sense that it is costly to negotiate this element as a precursor to settlement for every case, but it is anticipated that many of the transactions will be governed in large part by uniform bodies of law, such as the Uniform Commercial Code. Parties involved in a dispute in the International context

⁴ Eidsmore, Daniel. "Calling Their Bluff: Settlement Rates Low but Hopes Still High for Resolution of Personal Injury Claims," *Dispute Resolution Magazine*. 2000.

would face a similar choice of laws problem, but since the alternative to ADR is limited due to jurisdictional problems, parties desiring some form of settlement will have incentives to cooperate with the ADR regime.

4) Does this ADR program provide information to a consumer before he or she is asked to agree to submit disputes to the program? At what point and how is this information provided?

Effective dispute resolution processes must be as transparent as possible. Especially when the process is carried out through a new medium like the Internet, the parties must be given as much information as possible before they submit to such processes so they can make informed decisions. Consent based on misunderstanding may undermine the entire process. Online ADR service providers have the obligation to educate potential customers about the realities of online ADR.

Online ADR shops can fulfill the obligation to gain informed consent in a number of ways. Each ADR site must have specific terms of service that detail procedures. Parties should assent to these terms at the time of case submission. Once a client accepts the ADR process, there should be another process disclosure/training session. In the content-based, neutral-managed online ADR context, this training should consist of a preliminary dialogue between the neutral and the disputants. As a part of this dialogue, the parties could shape processes and determine essential parameters of the ADR process.

5) What are the procedural effects of this program, for example, to what extent are decisions binding? To what extent are they appealable for a decision? Is participation in the program a prerequisite to filing a law suit?

The extent to which ADR decisions are binding depends on which ADR process produces the decision. Since parties usually have a mutual interest in the continued integrity of the ADR system, as well as a set of efficiency concerns, they usually submit to the ADR process voluntarily. All ADR processes are conducted in the “shadow of the law.”⁵ Often, parties have the right to opt out of ADR processes, ex ante. Even in the ADR process, parties retain certain legal remedies that can be raised to end the process or to review the settlement in limited cases. To some extent, the parties’ ability to exercise certain legal rights depends on the ADR process and the specifics of the relevant agreement.

Negotiation and mediation, because they are voluntary processes that are controlled by the parties, usually do not involve significant ex post enforcement problems. In the event of a settlement, the parties can agree to certain enforcement mechanisms going forward. Parties with compliance concerns could also structure the deal to minimize opportunities for non-compliance. For instance, the parties could agree to use an escrow agent to make payments. Because the parties can structure the agreement,

⁵ See, Robert H. Mnookin & Lewis Kornhauser, Bargaining in the Shadow of the Law: The Case of Divorce, 88 Yale L.J. 950, 951 (1979).

there is room for creative solutions. Parties can structure incentives into the resolution to maximize the chances of compliance. In the mediation setting, the neutral can facilitate the structuring of an agreement with mutual incentives aimed at maximizing compliance.

A resolution arising out of a negotiation or a mediation is binding and appealable to the extent that the parties want it to be. Because negotiation and mediation are self-help through contract, traditional contract remedies exist for appeal. Failure to conduct the settlement processes in good faith or non-compliance with the settlement is the more likely response of a party that is not satisfied with the process or with the agreement.

In the context of arbitration, the process has usually been designated by contract as binding or non-binding at the outset. In the binding arbitration setting, most arbitration agreements require the parties to waive certain rights of adjudication. Binding arbitration decisions are binding to the extent that they comply with relevant law. Parties retain the right to file a complaint in court to review the holding, but the moving party will have to meet the burden of proof associated with its claims. The courts have an interest in avoiding the business of reviewing arbitration agreements. This goal is best accomplished by setting the precedent of upholding arbitration agreements that meet minimum standards of fairness and due process.

Although it may be the case that negotiation is frequently attempted before filing a law suit, there are no formal requirements to negotiate before taking more formal actions. Often, a party will file the lawsuit first to get the other party to participate in settlement talks. Several courts have experimented with mandatory mediation in various legal settings. The results of these experiments have been largely positive—settlement and satisfaction rates have been about as high as the voluntary process. The concerns with such mandatory programs spring from their applicability to certain types of disputes as well as the voluntary nature of mediation. If two parties simply do not want to mediate, any forced mediation may simply be a waste of resources. However, parties' aversion to mediation is often due to misunderstanding. For this reason, many courts have implemented mandatory ADR education campaigns. Indeed, Congress has required that federal courts provide education about and access to ADR processes in the Alternative Dispute Resolution Act of 1998.⁶

7) What are the costs to the parties engaging in ADR? Who funds these costs? Is this program cost-effective? Is it suitable for small-dollar transactions? Does this program handle a large volume of disputes? Is it capable of doing so?

ADR costs are usually scaled down considerably from the costs of traditional adversarial processes. The major expenses of ADR are representation, discovery processes and neutral fees. Although ADR can be costly, in most cases, it is much cheaper than any adjudicatory alternative. Parties facing large damage awards can minimize costs by structuring payments over time. Also, since ADR is considerably faster than adjudication, parties capture value through the speedy resolution of their claims.

⁶ See footnote 2, *supra*.

There are several ways to allocate the costs of ADR. Generally speaking, the costs can be allocated to the disputants or to a third party, such as the appropriate court. Allocating costs to the parties is the most common way to fund the ADR process. Disputants benefit from ADR so they are usually willing to pay for the process. Some courts, such as some of the federal courts in Northern California, have programs that provide ADR service free of charge for the initial stages and, after a certain number of hours, require the parties to pay if they want to continue the ADR process. This two-tiered costs structure allows the parties to enter ADR processes without the risk of losing money, giving them a chance to learn more about the process.

Certain types of ADR are appropriate for small claims. Because small claims are most often not complex and can usually be represented by a dollar amount, they are well suited to mediation or even to some form of arbitration. Some courts have mandatory mediation programs for small claims. These programs cost nothing in addition to the filing fee. In the case of a small claim that is not subject to one of these court-sponsored programs, ADR could still be cost effective if the fee structure were based on a flat-fee system or on a percentage of the settlement. However, the danger with these fee structures is that they incentivize the neutral to expedite the process, which can jeopardize the integrity of the process.

Online ADR will be well suited to handle a large volume of disputes. The capacity of any ADR program is defined by its access to neutrals. Because of ADR's increasing popularity, the number of qualified neutrals is continually growing. Therefore, most ADR services should be able to scale up to meet high levels of demand. Online ADR will allow greater scalability than traditional dispute resolution channels. The Internet is unique in that it allows parties to communicate asynchronously; the elimination of physical and synchronous meetings will increase the neutral's case management abilities. Thus, the quantitative limits of online ADR will easily surpass those of traditional ADR.

8) Is ADR for online consumer transactions better suited to certain situations than others, for example, cross-border disputes or cases limited to a certain monetary amount? Are there any other factors relevant to determining whether ADR is suited to particular online consumer transactions?

Although online ADR for online consumer transactions is well suited to handle any transaction dispute, it is particularly well suited to resolve disputes between parties that are geographically disparate, especially when the amount in question is not sufficient to merit the time and travel expenses of off-line dispute resolution. Because the Internet currently limits communication to text, in the short-term, it may not be suitable for certain complex cases involving many different interests; however, WebMediate's research has shown that such complex cases are not typical between a buyer and a seller online. As technology improves, the communication limits of the Internet will be eliminated and the Internet will be the medium of choice for the resolution of all disputes.

The Internet is well suited to handle online high-dollar-figure commercial disputes. In fact, resolving these disputes online is the best way to leverage the Internet. The major difficulty in attracting high-dollar transaction disputes is the parties' willingness to pay for resolution may eliminate process expense as a consideration and shrink the attractiveness of online ADR. However, since even high-dollar-figure transactions on the Internet typically involve thin margins, parties will still be interested in minimizing transaction costs and therefore use online ADR. In addition, it is expected that several parties will be repeat players: Once a party has a positive experience with online ADR, trust will increase and that party will repeat. Such has been the case with the proliferation of offline ADR.

10) What are the obstacles, if any, to the implementation of alternative dispute resolution programs for online consumer transactions? What are the incentives and disincentives for businesses and consumers to use such programs?

The principal obstacles to the broad implementation of online ADR for online consumer transactions are education and inertia. Education has to take place on two levels. The first level concerns the basic security of transacting on the Internet. The second level concerns ADR as a reliable and fair mechanism for dispute resolution online and off-line. As commercial firms and consumers become more knowledgeable about Internet transactions and Internet dispute resolution, confidence in online transaction dispute resolution systems will increase and the online ADR paradigm will take hold.

To usher in a new model for transaction dispute resolution on the Internet, parties must have the confidence to conduct transactions online. General familiarity with and confidence in the Internet architecture is a necessary basis for parties to be willing to attempt dispute resolution online. Parties must have confidence in that the system will be able to protect confidential communications and transfer documents across parties in a secure way.

Disputants in the online commercial transaction context will also have to believe ADR is a process that can improve the resolution of a commercial dispute. General confidence in ADR relates to both the online and the off-line context. Because ADR is a relatively recent phenomenon, many parties to consumer transactions may not know much about ADR or, more specifically, about online ADR.

Workshop

17) What should be the primary focus and scope of the public workshop on alternative dispute resolution for online consumer transactions?

The workshop should aim to accomplish the following three goals:

A. Education:

Since one of the major barriers to greater online ADR market penetration is a lack of knowledge among consumers, the participants in the conference should undertake a dialogue to determine an appropriate strategy to educate potential consumers about the benefits of online ADR. The FTC should play an active role in the education of the general public about the benefits of online ADR. In addition to educating the general public, the FTC and the ADR community must undertake an effort to educate the e-commerce community. One of the largest problems faced by ADR systems is a lack of commitment from potential participants. This public workshop must work to developing a systematic plan to increase awareness among the e-commerce community and the general community of consumers to increase their confident and commitment level.

B. Establishment of Industry Standards:

As online ADR develops, certain standard protocols will emerge. To some extent, these protocols already exist in the off-line ADR context. This conference should be used as a forum to begin the dialogue directed at establishing a set of online ADR best practices. These practices should be directed at technical and substantive issues. For instance, standards could be discussed on minimum site security levels or on the training of neutrals. Because of the broad participation, the conference will provide an appropriate forum to discuss and publicize the development of a set of online ADR standards to foster consumer confidence.

C. Continued Governmental Support:

The conference should be used to further relations between private providers of Online ADR services and the government. The government should commit to the support of online ADR. Specific measures should be presented by which the government will work to increase the visibility of online ADR to increase the safety and efficiency of transacting online. In return, online ADR providers should commit to follow certain standards to maintain high levels of quality and security.